

# Corporate Frauds Legal and Regulatory frameworks in India: An analysis

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## Abstract

Corporate fraud is a widespread issue that positions a significant threat to the financial stability and credibility of businesses. This article explores into the details of corporate fraud, its element, legislative frameworks, and a case study related to the corporate fraud. In the corporate context, fraudulent activities often revolve around false financial practices, such as falsifying records or manipulating financial statements. In India, a comprehensive legal framework is in place to combat corporate fraud. The Companies act of 2013 established the foundation for corporate governance, ensuring transparency and accountability. The prevention of corruption act and the prevention of money laundering act further support the legal resource against fraudulent activities. Regulatory bodies like securities and exchange board (SEBI) of India, the central vigilance commission (CVC), and the Lokpal & Lokayukta play a important roles in monitoring and regulating corporate practices, contribution to the prevention and detection of fraud.

Understanding of corporate fraud requires a comprehensive approach involving legal frameworks, functioning of regulatory bodies, and ethical corporate practices. The legislative provisions in India, coupled with the actions of regulatory bodies, aim to raise a corporate environment built on integrity and transparency. This research paper analyses the lacuna in the existing legal framework leading to major scams in India.

Keywords: Company Act, Legal framework, Corporate fraud, CVC, Money laundering act, Lokpal & Lokayukta, SEBI, Corruption act.

## INTRODUCTION

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Corporate frauds in India have arisen as a huge concern, reflecting more extensive difficulties inside the country's corporate administration scene. The frauds include monetary errors, theft, insider exchanging, and different types of wrongdoing, which sabotage financial backer trust, mutilate market honesty, and dissolve investor esteem<sup>3</sup>. The predominance of corporate cheats in India is highlighted by a few high-profile outrages that have shaken the groundworks of the business. These occurrences feature weaknesses inside individual organizations as well as uncover fundamental shortcomings in administrative oversight, implementation systems, and corporate administration norms. In this unique situation, figuring out the elements, patterns, and ramifications of corporate fakes in India is pivotal for partners, policymakers, and administrative bodies trying to defend the respectability and strength of the country's monetary environment.

In response to these scandals, the government and regulatory bodies have strengthened their mechanisms to mitigate fraud, aiming to restrict the collusion between companies and professionals, as well as officials. It is often achieved through increased disclosures and by assigning clear responsibilities to each party involved in fraudulent activities. Despite the adoption of corporate governance principles and the presence of numerous legislations and regulatory bodies, corporate fraud remains pervasive across the country. It is imperative to examine the perception of corporate frauds in India and highlight emerging issues to ensure that existing legal and regulatory obligations are effectively upheld.

#### Corporate Fraud :

When companies engage in activities that are dishonest or illegal it is referred to as corporate fraud. Section 447 of the Companies Act, 2013, states "fraud", in relation to affairs of a company or any body corporate: includes any act, omission concealment of fact, or abuse of position committed by any person or any other person with connivances in any manner with intent to deceive, to gain due advantage from or injure the interest of the company or its shareholders or creditors, or any other person, whether or not there is any wrongful gain or wrongful loss<sup>4</sup>.

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<sup>3</sup> Payel Chatterjee and Aman Singhania : Early detection and reporting of frauds in India: Widening the regulatory net, International Bar Association. Available at: <https://www.ibanet.org/early-detection-and-reporting-of-frauds-in-india> Pg: 1 (2023)

<sup>4</sup> Section 447 of companies act 2013, India code digital repository of laws- a system of law for communication available at [www.indiacode.nic.in/](http://www.indiacode.nic.in/) visited 20/02/2024

Section 25 of the Indian penal code, 1860 define 'Fraudulently' , as person is said to do a thing fraudulently if he does that thing with intent to defraud but not otherwise<sup>5</sup>.

Under section 17 of the Indian Contract Act, of 1872, fraud is defined as any act committed by a party to a contract or with his connivance or by his agents, to deceive or trick the other party, his agent, or to induce him to enter into the contract<sup>6</sup>.

In Dr. Vimal V/s Delhi administration 1963 AIR 1572 the court examined the definition of "fraudulently" and emphasized that it involves deceit and injury. While fraud typically results in an advantage to the perpetrator and a corresponding loss to the victim, it is not limited to economic harm<sup>7</sup>.

### Kinds of Corporate Frauds

- Financial Statement Fraud

This kind of extortion includes the deliberate deception or control of fiscal reports to trick financial backers, leasers, or controllers. Models incorporate swelling incomes, downplaying costs, or exaggerating resources to make a mixed signal of the organization's monetary well-being.

- Embezzlement

Theft happens when people dependent on overseeing assets or resources of an organization misuse those assets for individual increase. This can include redirecting cash, moving organization assets to individual records, or misrepresenting cost reports.

- Insider Trading

Insider exchanging happens when people with admittance to classified, non-public data about an organization utilize that data to exchange stocks or protections for individuals increase<sup>8</sup>. This unlawful practice subverts market respectability and unreasonably inconveniences different financial backers who don't approach a similar data.

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<sup>5</sup> Section 25 of Indian Penal Code, 1860, Indian kanoon , available at [www.indiankanoon.org/doc](http://www.indiankanoon.org/doc), visited at 21/02/2024

<sup>6</sup> Section 17 of Indian contract Act, 1872, India code digital repository of laws- a system of law for communication available at [www.indiacode.nic.in/](http://www.indiacode.nic.in/) visited 20/02/2024

<sup>7</sup> Dr. Vimal V/s Delhi administration 1963 AIR 1572 available at [indiankanoon.org/doc/](http://indiankanoon.org/doc/) visited at 06/03/24

<sup>8</sup> Aishwarya Pandey: Corporate crime and penal policy in India: an analytical study.4 J. IJLMH, Pg 606, 607, 2021

- Bribery and Corruption

Pay off includes offering, giving, getting, or requesting something of significant worth to impact the activities of a person in a, influential place or authority. Defilement inside a corporate setting can include paying off open authorities, taking part in payoff plots, or working with ill-advised deals to unreasonably acquire benefits.

- Kickbacks and Procurement Fraud

Payoffs include offering or tolerating installments, gifts, or Favors in return for granting contracts or ideal treatment in obtainment processes<sup>9</sup>. This sort of misrepresentation can expand contract costs, compromise the nature of labour and products, and sabotage fair rivalry.

- False Billing and Expense Fraud

Bogus charging happens when people or sellers submit fake solicitations or billings for labor and products that were not given, were overrated, or were not approved. Cost misrepresentation includes representatives submitting misleading or swelled cost reports to get repayment for individual costs.

## Legal Provision Dealing Corporate Fraud in India

### a. Company Act 2013

Section 447, 448, 449 & 450 of the Company Act 2013 recommends punishments for people seen as at legitimate fault for misrepresentation corresponding to the undertakings of an organization. It expresses that any individual who is viewed as a legitimate fault for misrepresentation including a measure of no less than ten lakh rupees or one percent of the turnover of the organization, whichever is lower, will be culpable with detainment for a term going from a half year to a decade, and will likewise be at risk to fines<sup>10</sup>. Company Act 2013 outlines the penalties for various offenses under this act. individuals found guilty of fraud in relation to the company's activities face imprisonment for a term from six months to ten years, along with fines. false statements in documents required by the act may lead to imprisonment for 2 years or fines<sup>11</sup>. Providing false

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<sup>9</sup> Ellery, A. Different types of corporate fraud explained - resource, Francis Wilks & Jones. Available at: <https://www.franciswilksandjones.co.uk/corporate-fraud-types> (2023)

<sup>10</sup> Section 447 of Company Act, 2013 define "fraud", in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

<sup>11</sup> Section 448 of Companies Act 2013, India code digital repository of laws- a system of law for communication available at [www.indiacode.nic.in/](http://www.indiacode.nic.in/) visited 20/02/2024

evidence during any procedure under the act could result in imprisonment for up to seven years, in addition to fines. In instances where specific penalties are not stipulated, offenders may face imprisonment for up to six months, fines up to one lakh rupee, or both<sup>12</sup>. Repeat offenders, particularly those involved in extortion, face enhanced punishment with imprisonment ranging from 1 to 5 years, in addition to fines. These punishments aim to deter fraudulent activities within organizations and uphold transparency and integrity in financial reporting. By imposing significant penalties, the legislation seeks to protect stakeholders, investors, and the public from financial misconduct and deception. Additionally, the provision for enhanced penalties for repeat offenders underscores the seriousness with which the law treats such offenses and emphasizes the importance of compliance and ethical conduct in corporate affairs<sup>13</sup>. Overall, the prescribed penalties aim to promote accountability, deterrence, and adherence to legal and ethical standards within organizations operating under the purview of the Organizations Act.

#### Prevention of Money Laundering Act, 2002

The Prevention of Money Laundering Act of 2002 (PMLA) stands as a crucial piece of legislation in India, specifically targeting corporate fraud by primarily focusing on preventing money laundering activities<sup>14</sup>. Although its main objective is to combat money laundering, many of its provisions also serve to prevent and detect various forms of corporate fraud. Money laundering, as defined by the PMLA, involves concealing the origins of illegally obtained money, typically by transferring it through a complex sequence of banking or commercial transactions to mask its unlawful origins. The Act outlines the offense of money laundering, encompassing any direct or indirect attempt or assistance in engaging in activities related to the proceeds of crime. This includes concealing, possessing, acquiring, or using such proceeds, as well as presenting or asserting them as legitimate property. Those found guilty of money laundering face rigorous imprisonment ranging from 3 to 7 years, along with fines. In cases where the proceeds of crime are linked to offenses listed under the Narcotic Drugs & Psychotropic Substances Act of 1985, the punishment may extend to up to 10 years of rigorous imprisonment, in addition to fines. The PMLA empowers certain officials, such as Directors, Joint Directors, or Deputy Directors, to provisionally attach property for up to 180 days if there are grounds to suspect that an individual possesses proceeds of crime and there is a likelihood of concealing or transferring them. These officials must follow prescribed procedures, including documenting reasons for suspicion and

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<sup>12</sup> Section 449 of Companies Act 2013, India code digital repository of laws- a system of law for communication available at [www.indiacode.nic.in/](http://www.indiacode.nic.in/) visited 20/02/2024

<sup>13</sup> Section 450 of Companies Act 2013, India code digital repository of laws- a system of law for communication available at [www.indiacode.nic.in/](http://www.indiacode.nic.in/) visited 20/02/2024

<sup>14</sup> Kavita Natarajan, *Combatting India's Heroin Trade through Anti-Money Laundering Legislation*, 21FORDHAM INT'L L.J. 2014 (1998).

sending them to the adjudicating authority within a sealed envelope. Adjudicating Authorities, appointed by the Central Government, exercise jurisdiction, powers, and authority under the Act. Upon receiving a complaint, if the Adjudicating Authority suspects an individual has committed a money laundering offense or is in possession of proceeds of crime, they issue a notice requiring disclosure of income sources and reasons why the property should not be confiscated. After a hearing, the Authority determines if any property is involved in money laundering and confirms attachment through a written order. Confiscated property is transferred to the Central Government. Reporting entities, such as banks and financial institutions, are mandated to maintain transaction records, verify client identities, and keep documentation confidential. They are subject to fines if they fail to comply with these provisions. Immunity from civil proceedings is granted if requested information is provided to the authority. Procedures for maintaining and providing information are established by the Central Government in consultation with the RBI. Authorized officers are empowered to conduct searches, seizures, and arrests in cases of suspected money laundering offenses, with property retention limited to 180 days. All offenses under the Act are deemed cognizable, and bail may only be granted under specific conditions outlined by the Special Court. Police officers require explicit authorization to investigate offenses under the Act<sup>15</sup>.

### Prevention of Corruption Act, 1998

The Prevention Corruption Act of 1988 (PCA) serves as a crucial legal framework in India aimed at combating corruption across various sectors, including the corporate domain. While its primary focus is on preventing bribery and corruption involving public officials, the PCA also holds implications for addressing corporate fraud. By deterring corrupt practices, promoting transparency, and holding individuals and entities accountable for their actions, the PCA contributes to maintaining the integrity and credibility of India's corporate sector and public institutions. According to the Global Corruption Barometer, India was designated as the most corrupt country in Asia. 39% of the population admitted to participating in bribery, while 46% acknowledged utilizing personal networks to gain access to public services. Additionally, almost half of those who paid bribes reported being solicited, whereas 32% of those who relied on personal connections believed they would be denied services otherwise. Despite these figures, 63% of respondents expressed confidence in the government's efforts to combat corruption<sup>16</sup>. Corruption disproportionately affects the impoverished and the most vulnerable, leading to heightened expenses and diminished accessibility to essential services such as healthcare,

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<sup>15</sup> Binod Poddar and Shalini Singh, prevention of Money Laundering Act,2002- an overview, published by manupatra

<sup>16</sup> Aneira Pereira, Anti-Corruption Legislation in India: Effective or Ineffective?, 2 INDIAN J.L. & LEGAL RSCH. pg 2 (2021).

education, and legal representation. In India, corruption not only jeopardizes the efficacy of governance but also undermines the fundamental pillars of democracy, the rule of law, and the nation's sovereignty at an alarming rate<sup>17</sup>. Under the PCA, criminal liability is imposed on individuals or entities found to be responsible for committing offenses outlined in the Act. This includes corporate executives or employees engaged in bribery, kickbacks, or other corrupt practices to gain undue advantages in business transactions. The Act prescribes stringent penalties, including imprisonment and fines, for corruption-related offenses. Those found guilty of offering or accepting kickbacks, whether in the public or private sector, can face significant penalties. Additionally, the PCA incorporates provisions for the prevention and detection of corruption. It empowers anti-corruption agencies to investigate complaints, conduct raids, and gather evidence against wrongdoers, facilitating the investigation of cases involving corporate fraud and corruption. The Act also provides protection for whistleblowers who report instances of corruption or bribery, encouraging individuals, including corporate employees, to come forward and disclose information without fear of retaliation. Moreover, while the PCA primarily focuses on individual liability, it also recognizes corporate responsibility for offenses committed by an organization's officials or employees. Corporations can be held vicariously liable for the actions of their employees if it can be established that the offense was committed to benefit the company. Overall, the PCA plays a vital role in combating corruption and ensuring accountability within the corporate sector, contributing to the maintenance of ethical standards and trust in India's business environment.

### Regulatory authorities:

#### a. Securities Exchange Board of India (SEBI)

The Securities Exchange Board of India (SEBI) is the essential administrative authority managing the protection market in India. Laid out in 1988, SEBI works under the Protections and Trade Leading Group of India Act, 1992, and has legal abilities to control and safeguard the interests of financial backers in protection, advance the improvement of the protection market, and direct the protection market and go-betweens. SEBI assumes a basic part in guaranteeing the honesty, proficiency, and strength of the protection market in India. Its administrative oversight and requirement activities are pointed toward encouraging financial backer certainty, keeping up with market honesty, and working with the development and improvement of the Indian capital market<sup>18</sup>.

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<sup>17</sup> Sanyukta Moitra, combating corruption in India through right to information: an analysis, 9 Indian J.L & just . pg . 128, 2018

<sup>18</sup> Jishnu Sanyal: a critical review of SEBI in the backdrop of financial scams, published by SSRN pg.2

A cornerstone of SEBI's mandate is investor protection, whereby it endeavors to safeguard the interests of investors by promoting fair practices, ensuring adequate disclosure of information, and combating fraudulent and unfair trading practices. Through stringent regulations and enforcement mechanisms, SEBI seeks to instill confidence among investors and maintain the integrity of the market. SEBI also exercises regulatory oversight over intermediaries operating in the securities market, including stockbrokers, merchant bankers, portfolio managers, investment advisers, and credit rating agencies. It establishes eligibility criteria, registration requirements, and conduct norms for these intermediaries to uphold market integrity and investor confidence. Market surveillance and enforcement are integral components of SEBI's regulatory framework. Through vigilant monitoring, SEBI identifies and prevents market manipulation, insider trading, and other fraudulent activities. It possesses enforcement powers to investigate violations of securities regulations, impose penalties, and take disciplinary actions against errant entities and individuals. In addition, SEBI regulates takeovers and mergers of listed companies through the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011<sup>19</sup>. It ensures transparency, fairness, and protection of minority shareholders' interests in corporate transactions. Moreover, SEBI is actively involved in promoting market development initiatives, including the introduction of new products and trading platforms, enhancing market infrastructure, and facilitating access to capital for issuers. These efforts are geared towards fostering innovation, liquidity, and efficiency in the securities market, thereby contributing to its overall growth and development.

### Central Vigilance Commission

In the late 1950s, responding to concerns expressed by Members of Parliament regarding widespread corruption, the Government of India established a committee to review existing measures for combating corruption in central government organizations and recommend practical steps for enhancing anti-corruption efforts. This committee, chaired by Shri K. Santhanam, a Member of Parliament, became known as the 'Santhanam Committee.' On 11th February 1964, the Government of India passed a resolution, taking into account the recommendations of the Santhanam Committee, leading to the establishment of the Central Vigilance Commission (CVC). The Commission was deemed necessary to establish and apply uniform standards in addressing cases of probity and integrity in public life. Endowed with significant independence and functional autonomy, as mandated by the CVC Act, the commission aligns with international anti-corruption

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<sup>19</sup> Anand Swaroop Das & Anand Vardhan Narayan, SEBI's Jurisdiction on Corporate Governance in India: A Critical Assessment, 1 J. oN GOVERNANCE pg. 954 (2013).



standards. The CVC oversees vigilance administrations across ministries and departments, conducts inquiries, offers advice, and supervises investigations related to corruption. Additionally, it exercises superintendence over the functioning of the Delhi Special Police Establishment, ensuring adherence to anti-corruption laws and procedures. This includes supervising the vigilance administrations of various Central Government Ministries, Departments, and Organizations, ensuring adherence to anti-corruption protocols. It conducts inquiries or investigations into allegations of corruption based on referrals from the Central Government or complaints received against officials under its jurisdiction. the commission also conducts preliminary inquiries into complaints forwarded by the Lokpal concerning officials of various grades, ensuring swift and thorough examination of alleged misconduct. Furthermore, it initiates inquiries into complaints received under the Public Interest Disclosure and Protection of Informers' Resolution, facilitating the appropriate resolution of issues raised by whistleblowers. the Delhi Special Police Establishment (CBI) concerning investigations under relevant anti-corruption laws and procedures<sup>20</sup>. It provides directives to the CBI regarding the conduct of investigations under the Prevention of Corruption Act, 1988, ensuring the enforcement of anti-corruption measures effectively. Moreover, the CVC reviews the progress of investigations conducted by the CBI and evaluates applications for prosecution sanction under anti-corruption legislation, ensuring accountability and due process.

### Conclusion and suggestions

corporate fraud has emerged as a significant threat globally, including in India, where fraudsters exploit financial institutions for immense rewards. Despite existing laws and regulations aimed at combating corporate fraud, society often finds itself grappling with the aftermath rather than proactively preventing it<sup>21</sup>. To effectively frighten fraudsters, legislators and regulators must take proactive measures, such as empowering investigators and regulators like SEBI, CVC, Lokpal and lokayukta adopting international financial reporting standards, and prioritizing the identification and prevention of fraud. Punishing corporate offenders, enhancing regulatory coordination among agencies like SEBI, CBI, ED, and SFIO, and implementing robust whistleblower policies are crucial steps toward reducing corporate fraud. By collectively prioritizing prevention over reaction, society can mitigate the impact of corporate fraud and safeguard financial integrity. companies should adopt robust corporate governance practices, including transparent disclosure

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<sup>20</sup> Biplab Kumar Lenin, Administration of central Vigilance Commission: a critical analysis, published by Manupatra, pg. 1

<sup>21</sup> Ms. Shweta Wadhvani and Dr. Hema Menon: Corporate Frauds: Emerging issues and preventive strategies: manupatra.com, Pg 61, (2017)

principles, independent board oversight, and ethical leadership. Strengthening internal controls, risk management frameworks, and whistleblower protection mechanisms can help prevent and detect fraudulent activities within organizations.

Some of the suggestions To prevent corporate fraud in India, the government should strengthen regulatory oversight by empowering bodies like SEBI, RBI, and the Ministry of Corporate Affairs. Transparency and disclosure requirements for listed companies should be enhanced, along with promoting greater transparency in decision-making processes. Enforcing stricter adherence to corporate governance principles, promoting whistleblower protection mechanisms, and enhancing the legal framework and enforcement are essential. Fostering an ethical culture within organizations through training and awareness campaigns is crucial. Collaboration with international agencies to combat cross-border financial crimes is necessary. Continuous monitoring through regular audits and risk assessments, along with independent investigations into suspected fraud, is vital. By adopting this multi-dimensional approach, India can effectively mitigate corporate fraud and uphold the integrity of its corporate sector.